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BEFORE THE ARIZONA CORPORATION COMMISSION

IN THE MATTER OF THE
APPLICATION OF LITCHFIELD PARK
SERVICE COMPANY, AN ARIZONA
CORPORATION, FOR A
DETERMINATION OF THE FAIR
VALUE OF ITS UTILITY PLANTS AND
PROPERTY AND FOR INCREASES IN
ITS WATER RATES AND CHARGES
FOR UTILITY SERVICE BASED
THEREON.

DOCKET NO: W-01427A-13-0043

Arizona Corporation Commission

DOCKETED

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ITS WASTEWATER RATES AND
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BASED THEREON.

DOCKET NO: SW-01428A-13-0042

INITIAL CLOSING BRIEF**January 17, 2014**

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TABLE OF ABBREVIATIONS AND CONVENTIONS

LPSCO uses the following abbreviations in citing to the pre-filed testimony and hearing transcripts in this brief. Other documents that were admitted as exhibits during the hearing are cited by hearing exhibit number. The final schedules will be cited as "Final Schedule XXX."* Other citations to testimony and documents are provided in full, including (where applicable) the Commission's docket number and filing date.

DEFINED TERMS

Full Name/Description	Abbreviated term
Arizona Corporation Commission	Commission
Arizona Corporation Commission Utilities Division Staff	Staff
Arizona Public Service Company, Docket No. E-01345A-11-0224, Proposed Settlement Agreement, dated January 6, 2012	APS Settlement Agreement
Arizona Water Company	AWC
Arizona Water Company-Eastern Group, Docket No. W-01445A-11-0310	AWC Rate Case
Arizona Water Company-Eastern Group, Docket No. W-01445A-11-0310, Phase 2	AWC SIB Settlement
Arizona Water Company-Eastern Group, Docket No. W-01445A-11-0310, Phase 2, Settlement Agreement Regarding Distribution System Improvement Charge and Other DSIC-Like Proposals, dated April 1, 2013	AWC Settlement Agreement
Arsenic Cost Recovery Mechanism	ACRM
Distribution System Improvement Charge	DSIC
Environmental Improvement Surcharge	EIS
Fair Value Rate Base	FVRB
Liberty Utilities (Litchfield Park Water & Sewer Corp.)	LPSCO or the Company

* The Final Schedules are attached to the Proposed Settlement Agreement Between LPSCO and RUCO (filed December 11, 2013) (Ex. A-17).

1	Full Name/Description	Abbreviated term
2	Liberty Utilities (Litchfield Park Water &	Parties
3	Sewer Corp.), Arizona Corporation	
4	Commission Utilities Division Staff and	
5	Residential Utility Consumer Office	
6	Plan of Administration	POA
7	Proposed Settlement Agreement Between	Settlement
8	LPSCO and RUCO in the LPSCO Rate Case,	
9	dated December 11, 2013	
10	Purchased Power Adjustment Mechanism	PPAM
11	Residential Utility Consumer Office	RUCO
12	System Improvement Benefit	SIB
13	Weighted Average Cost of Capital	WACC

LPSCO PRE-FILED TESTIMONY

14	Pre-Filed Testimony	Hearing Exhibit	Abbreviation
15	Direct Testimony of Greg Sorensen	A-1	Sorensen Dt.
16	Direct Testimony of Christopher	A-2	Krygier Dt.
17	Krygier		
18	Direct Testimony of Thomas J.	A-3	Bourassa Dt.
19	Bourassa (Rate Base)		
20	Direct Testimony of Thomas J.	A-4	Bourassa COC Dt.
21	Bourassa (Cost of Capital)		
22	Rebuttal Testimony of Christopher	A-5	Krygier Rb.
23	Krygier		
24	Rebuttal Testimony of Thomas J.	A-6	Bourassa Rb.
25	Bourassa (Rate Base)		
26	Rebuttal Testimony of Greg Sorensen	A-7	Sorensen Rb.
	Rebuttal Testimony of Thomas J.	A-8	Bourassa COC Rb.
	Bourassa (Cost of Capital)		
	Rebuttal Testimony of Wendell Licon	A-9	Licon Rb.

1	Pre-Filed Testimony	Hearing Exhibit	Abbreviation
2	Rejoinder Testimony of Christopher Krygier	A-12	Krygier Rj.
3			
4	Rejoinder Testimony of Thomas J. Bourassa (Rate Base)	A-13	Bourassa Rj.
5	Rejoinder Testimony of Greg Sorensen	A-14	Sorensen Rj.
6			
7	Rejoinder Testimony of Thomas J. Bourassa (Cost of Capital)	A-15	Bourassa COC Rj.
8	Rejoinder Testimony of Wendell Licon	A-16	Licon Rj.
9			

10 **RUCO PRE-FILED TESTIMONY**

11	Pre-Filed Testimony	Hearing Exhibit	Abbreviation
12	Direct Testimony of Robert Mease	R-1	Mease Dt.
13	Surrebuttal Testimony of Robert Mease	R-2	Mease Sb.
14			
15	Direct Testimony of Robert Mease (Rate Design)	R-3	Mease RD Dt.
16			

17 **STAFF PRE-FILED TESTIMONY**

18	Pre-Filed Testimony	Hearing Exhibit	Abbreviation
19	Direct Testimony of James Armstrong	S-1	Armstrong Dt.
20			
21	Direct Testimony of Dorothy Hains	S-2	Hains Sb.
22	Surrebuttal Testimony of Dorothy Hains	S-3	Hains Sb.
23			
24	Direct Testimony of John Cassidy	S-4	Cassidy Dt.
25	Surrebuttal Testimony of John Cassidy	S-5	Cassidy Sb.
26			
	Direct Testimony of Darron Carlson	S-6	Carlson Dt.

Pre-Filed Testimony	Hearing Exhibit	Abbreviation
Surrebuttal Testimony of Darron Carlson	S-7	Carlson Sb.
Direct Testimony of Darron Carlson (Rate Design)	S-8	Carlson RD Dt.

OTHER PORTIONS OF THE RECORD

Document	Hearing Exhibit
Notice of Errata (Rebuttal Schedule H-3, page 4)	A-10
Notice of Errata (Rebuttal Schedule D-1)	A-11
Final Settlement Agreement and Schedules	A-17
Direct Testimony of Greg Sorensen (Arizona Water Company Rate Case)	A-18
Settlement Agreement (Arizona Water Company Rate Case)	A-19
Engineering Report (Wastewater)	A-20
Engineering Report (Water)	A-21
Draft Plan of Administration (Wastewater)	A-22
Draft Plan of Administration (Water)	A-23
RUCO's Response to DR 2.8	A-24
Finalized Plan of Administration (Wastewater)	A-25
Finalized Plan of Administration (Water)	A-26
Plan of Administration (Wastewater), dated December 10, 2013	R-4
Decision No. 73938	judicial notice
Testimony of Patrick Quinn (Arizona Water Company Rate Case)	R-8

1	Document	Hearing Exhibit
2	Testimony of William Rigsby Quinn	R-9
3	(Arizona Water Company Rate Case)	
4	RAPA Comments	R-10
5	Oct. 16, 2013 Errata	S-9
6	Oct. 21, 2013 Errata	S-10
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1 LPSCO hereby submits its Initial Closing Brief in support of its application for rate
2 increases for its water and wastewater utility divisions.¹

3 **I. INTRODUCTION**

4 The Parties have reached agreement in this rate case on all of the components
5 necessary to set new rates - rate base, operating income, rate of return, and rate design.
6 This agreement is reflected in the Settlement entered into between the Company and
7 RUCO, and in the testimony filed by Staff in support of the terms of the Settlement on
8 December 12, 2013.² Witnesses from each of the Parties expressed unqualified support
9 for the Settlement at the hearings on December 13, 2013.³ In fact, there is literally only
10 one question that has not been resolved between the Parties. That question is whether the
11 Commission should approve the Company's request for SIB mechanism charges for its
12 water and wastewater divisions.

13 LPSCO and Staff are in full agreement regarding the request to approve water and
14 wastewater SIBs.⁴ Staff fully evaluated the Company's financial and engineering
15 information in support of its request and found the information adequate and the proposed
16 plant improvements to be reasonable and prudent.⁵ Additionally, Staff and the Company
17 have worked diligently together on the development of POAs for the SIBs.⁶ LPSCO is
18 using the form of POA under development by Staff since the AWC SIB Settlement,
19

20 ¹ The key for defined terms, abbreviations and citations to a witnesses' pre-filed testimony is set forth in
21 the Table of Abbreviations and Conventions in pages ii to vi following the Table of Contents. The table
22 also lists the hearing exhibit numbers of the parties' pre-filed testimony. Except where noted, other
hearing exhibits are cited by the hearing exhibit number and, where applicable, by page number, e.g.,
Ex.R-13 at 2. The transcript of the hearings is cited by page number, e.g., Tr. at 1.

23 ² See Exs. A-17 and S-1.

24 ³ E.g., Tr. at 25, 40, 45.

25 ⁴ The Company's sister public service corporation participated in the AWC SIB Settlement, and like Staff,
Liberty Utilities is a party to the AWC Settlement Agreement. See *AWC Rate Case*, Decision No. 73938
(June 27, 2013) at Attachment A (admitted as Ex. A-19 in this rate case).

26 ⁵ See, e.g., Tr. at 199-200.

⁶ Exs. A-25 and A-26.

1 and RUCO has had input on the development of the POA by virtue of its participation in
2 this proceeding. The POAs generally contain all of the same material terms and
3 conditions as the AWC SIB Settlement as modified and approved in Decision No. 73938.⁷
4 Accordingly, approval of the water and wastewater SIBs in this rate case will advance the
5 Commission's development of these important ratemaking tools.

6 RUCO opposes the approval of the requested SIBs in this case. That's not
7 surprising – RUCO opposed the AWC SIB Settlement and has sought rehearing and/or
8 appealed all prior Commission decisions approving these DSIC-like mechanisms for
9 water utilities.⁸ RUCO's opposition to the SIBs, however, is indistinguishable from its
10 opposition to the AWC SIB Settlement and the AWC SIBs.⁹ Moreover, RUCO's
11 arguments against the SIBs are (1) inconsistent with its position in several other
12 Commission proceedings; (2) unsupported by substantial evidence; (3) unsupported by the
13 applicable law; and (4) contrary to the clear Commission policy to promote rate
14 gradualism and ensure the continuation of safe and reliable utility services by supporting
15 the replacement of critical utility infrastructure. For these reasons, RUCO's arguments
16 should be rejected again.

17 **II. SUMMARY OF SETTLEMENT**

18 One familiar with Commission ratemaking proceedings might conclude that any
19 settlement agreement between the applicant utility and RUCO that has been adopted and
20 blessed by Staff is inherently fair and reasonable. Nevertheless, the Company recognizes
21 that it is this Commission that must conclude that the rates resulting from the Parties'
22 agreement are just and reasonable. In this case, the Commission can readily reach that
23 conclusion. The Parties' recommended rates for water and wastewater utility service are a

24 ⁷ See Tr. at 90; Krygier Rj. at 6:20 – 7:1.

25 ⁸ See RUCO's Application for Rehearing of Decision No. 74081 (filed Oct. 11, 2013 in Docket No. W-01445A-12-0348).

26 ⁹ See Tr. at 231:13-19.

1 fusion of all three Parties' positions and the result of their combined efforts to compromise
2 and reach resolutions on the issues in dispute.¹⁰

3 The Parties are recommending rate bases equal to \$33,103,506 and \$24,190,673 for
4 the water and wastewater divisions, respectively.¹¹ These rate bases reflect a number of
5 plant reclassifications recommended by Staff and inclusion of post-test year plant that all
6 parties agree is used and useful in serving test year customers.¹² The Parties have further
7 agreed that LPSCO's reasonable annual operating expenses are equal to \$9,724,351 and
8 \$8,585,970, and that a Declining Usage Adjustment is appropriate with the same
9 safeguards recommended by RUCO and adopted by the Commission in Decision
10 No. 73938. The Parties also agree that the Company's request for a PPAM as modified by
11 Staff is reasonable, and the Company and Staff are prepared to file a POA for the PPAM
12 as recommended by Staff¹³ and ordered by the Commission.¹⁴ Finally, the Parties have
13 agreed that, under the circumstances of this case and as part of their agreement to resolve
14 all of the non-SIB issues in dispute, RUCO's recommended 9.2 percent return on equity
15 on a capital structure consisting of 84.13 percent equity and 15.87 percent debt (at a debt
16 cost of 6.40 percent) is fair and reasonable.

17 The resulting recommended revenue requirements for the water and wastewater
18 divisions are \$12,622,779 and \$10,704,021, respectively.¹⁵ The revenue increases
19 necessary to achieve the new revenue requirements are \$1,421,511 and \$341,225,
20 or 12.69 percent and 3.29 percent, for the water and wastewater divisions, respectively.¹⁶
21 Using the rate design developed and recommended by the Parties, the monthly bill for a

22 ¹⁰ See Tr. at 14 (Krygier).

23 ¹¹ Final Schedule A-1 (water and wastewater).

24 ¹² Final Schedule B-2, pages 1 and 2 (water and wastewater).

24 ¹³ Carlson Dt. at 37-38.

25 ¹⁴ See Tr. at 34-35.

25 ¹⁵ Final Schedule A-1(water and wastewater).

26 ¹⁶ *Id.*

1 ¾” residential water customer using 8,827 gallons per month will be \$26.87 (an increase
2 of \$2.54 or 10.45 percent), and the monthly bill for a residential wastewater customer with
3 median usage will be \$40.35 (an increase of \$1.36 or 3.49 percent).¹⁷ The Company’s low
4 income tariff would also be modified to reflect an increased discount from 15 percent to
5 30 percent for eligible customers.¹⁸

6 As the foregoing illustrates, based on the record and under the circumstances of this
7 rate case, the Settlement as supported by Staff results in just and reasonable rates.

8 **III. SIB SURCHARGES ARE IN THE PUBIC INTEREST AND SHOULD BE**
9 **APPROVED AS RECOMMENDED BY STAFF AND THE COMPANY**

10 The SIB mechanism is a surcharge mechanism that promotes rate gradualism by
11 encouraging utilities to replace water and wastewater infrastructure.¹⁹ As testified by
12 Mr. Krygier, LPSCO anticipates “over \$25M of improvements needed to ensure
13 continued system reliability” for its water and wastewater divisions.²⁰ If LPSCO were
14 able to fund those necessary replacement costs and then seek rate treatment in the normal
15 ratemaking process, customers would risk sudden and massive rate increases once the
16 plant replacements were “in service” and recognized in a rate case. As recognized by the
17 Commission in the Decision No. 73938, there’s a better way, one that allows for more
18 gradual rate changes while enabling utilities to raise the funds they need. The solution is
19 the SIB. Here, Staff and LPSCO carefully designed the SIBs to meet these challenges
20 while protecting ratepayers. The SIB will ensure that these necessary investments occur
21 and that customers are protected.

22 The SIB POAs for LPSCO’s water and wastewater divisions provide for recovery
23 of the capital costs (return on investment, income taxes and depreciation expense)

24 ¹⁷ Final Schedule H-2, page 1 (water and wastewater); *see also* Settlement at ¶¶ 3.3, 3.4.

25 ¹⁸ Settlement at ¶ 3.2.

26 ¹⁹ Krygier Dt. at 6; Krygier Rj. at 7; Ex. A-25 at 2; Ex. A-26 at 2.

²⁰ Krygier Dt. at 9.

1 associated with collection/distribution system improvement projects listed in SIB Plant
2 Tables I that have been verified as completed and placed in service and where costs have
3 not been included in rate base for recovery in this case.²¹ Those SIB-Eligible Projects are
4 necessary to provide and continue to provide proper, adequate and reliable service to
5 existing customers; are not designed to serve or promote customer growth; and will not
6 comprise an upgrade or expansion of existing plant unless justified for existing
7 customers.²² In this case, the evidence clearly shows that the SIBs will (i) enable LPSCO
8 to meet the challenge of replacing aging infrastructure; (ii) result in more gradual rate
9 increases, as strongly preferred by ratepayers; (iii) increase the time between and reduce
10 the complexity of rate cases; (iv) provide a direct monetary benefit to ratepayers through
11 the 5 percent efficiency credit, and (v) keep LPSCO financially healthy so it can continue
12 to provide safe and reliable water service.²³ It's crystal clear that the proposed SIBs serve
13 the public interest and benefit both customers and the Company.

14 **A. The Requested SIBs Share the Same Fundamental Features, Provisions**
15 **and Protections as the SIB Approved in Decision No. 73938**

16 In Decision No. 73938, the Commission approved a SIB for AWC under a
17 settlement agreement reached following open, transparent and extended negotiations
18 between AWC, Staff, RUCO and various intervenors.²⁴ The Commission made the
19 following determination on the AWC SIB:

20 *We believe that the SIB mechanism embodied in the [AWC] Settlement*
21 *Agreement, together with the additional financial information and*
22 *analysis required herein, is compliant with the Commission's*
23 *constitutional requirements, as well as the case law interpreting the*
Commission's authority and discretion in setting rates. As described in
the [AWC] Settlement Agreement, the SIB surcharge would be based on
specific, verified, and in-service plant additions that are reviewed by Staff

24 ²¹ Ex. A-25 at 2; Ex. A-26 at 2.

25 ²² *Id.*

26 ²³ Krygier Dt. at 9-15; Krygier Rb. at 24; Tr. at 80:1-83:5 (Krygier).

²⁴ Decision No. 73938 at 18; Ex. A-19.

1 and approved by the Commission prior to being implemented. AWC would
2 be required to submit annual summary schedules showing the actual cost of
3 the infrastructure, and supporting documentation that will enable Staff and
4 the Commission to determine how the proposed surcharge adjustments
5 would impact the fair value rate of return for each affected system.²⁵

6 Ultimately, the Commission stated that “[w]ith these provisions and protections, as
7 well as others discussed herein, we find that that [AWC] Settlement Agreement represents
8 a reasonable compromise of contested issues, is in accord with Arizona law and, as a
9 whole, is consistent with the public interest.”²⁶ Those findings apply here because the
10 proposed water and wastewater SIBs for LPSCO contain the same fundamental features
11 and protections supporting the SIBs as noted in Decision No. 73938 for the AWC SIB.

12 **1. LPSCO drafted and proposed its water and wastewater SIBs**
13 **using the Commission approved AWC SIB as a template.**

14 It bears emphasis that the SIBs for LPSCO were modeled after the AWC SIB.²⁷
15 As stated by Mr. Krygier, “in our rebuttal testimony, after the decision in [the AWC Rate
16 Case] had come out and the settlement agreement, we modified our request to mirror what
17 was in [the AWC Rate Case].”²⁸ Put simply, the LPSCO water and wastewater SIBs “are
18 materially the same” as the AWC SIB approved by the Commission in Decision No.
19 73938.²⁹ That stands to reason given that the AWC SIB was designed and intended to be
20 used as a SIB template for other utilities.³⁰ In fact, various Liberty, Global and EPCOR

21 ²⁵ Decision No. 73938 at 53 (emphasis added).

22 ²⁶ *Id.* at 54.

23 ²⁷ Krygier Rb. at 21:5-9.

24 ²⁸ Tr. at 75:24-76:2 (Krygier).

25 ²⁹ *Id.* at 76:7-8 (Krygier).

26 ³⁰ In the AWC Rate Case, Mr. Olea explained that “we were hoping that the Commission would approve
some type of DSIC mechanism; and that once that was approved, that mechanism could be used by other
companies that met the requirements of whatever mechanism was set up.” Transcript from April 11, 2013
hearing at 248:10-14, AWC Rate Case. *See also* Exhibit A-19 at 10, § 10.2 (“The Signatory Parties agree
that, although the SIB mechanism discussed in this agreement may be used as a template in other rate
proceedings, it is specific to AWC in Docket W-01455A-11-0310. The Signatory Parties further agree

1 utilities intervened as parties to the SIB proceedings in the AWC Rate Case and
2 participated in negotiations relating to the AWC SIB because it was intended that the
3 AWC SIB would be used a SIB template.³¹

4 Using the AWC Settlement Agreement as a template, LPSCO “hired an
5 engineering firm to do an engineering analysis that was similar to what the Arizona Water
6 group originally put together” and LPSCO submitted SIB “plan[s] of administration that
7 [are] materially the same [as] the settlement agreement that [the] parties signed into” in
8 the AWC case.³² It is undisputed that “the terms” of LPSCO’s SIB POAs “are materially
9 the same as the [AWC Settlement Agreement].”³³ The following discussion comparing
10 the LPSCO SIB POAs and the AWC Settlement Agreement confirms that the SIBs are
11 virtually identical.

12 2. Commission Pre-Approval of SIB-Eligible Projects.

13 Just like the AWC Settlement Agreement, all of the infrastructure replacement
14 projects contemplated for SIB recovery under the LPSCO POAs must be reviewed by
15 Staff and approved by the Commission prior to LPSCO filing for recovery of the capital
16 costs associated with such projects through a SIB surcharge.³⁴ The specific projects that

17 that Staff may recommend and/or that any utility may apply to the Commission for a similar SIB
18 mechanism for projects meeting the criteria outlined herein in a full rate case application.”).

19 ³¹ The following Arizona utilities all signed the AWC Settlement Agreement (Ex. A-19): AWC, Global
20 Water – Palo Verde Utilities Company, Global Water – Santa Cruz Water Company, Valencia Water
21 Company – Town Division, Valencia Water Company – Greater Buckeye Division, Water Utility of
22 Greater Tonopah, Willow Valley Water Co., Water Utility of Northern Scottsdale, EPCOR Water Arizona,
23 Inc., and Rico Utilities, Inc. dba Liberty Utilities.

24 ³² Tr. at 76:12-18 (Krygier); Krygier Rb. at 22:1-10. See also Tr. at 90:13-20 (Krygier) (“But I would
25 point you to, though, what we are saying I believe in my testimony is we are requesting that’s materially
26 similar to what was approved in [the AWC Rate Case]. And that’s why we pointed to that decision there.
And so while maybe the exact details aren’t there, you will see that the POA is extremely similar to the
[AWC] settlement agreement. So there is nothing materially different between the two.”).

³³ *Id.* at 91:19-23 (Krygier). Even further, RUCO witness Mr. Mease acknowledged that RUCO’s
objections to the LPSCO SIBs are the same arguments that RUCO made against the AWC SIB, and he
further admitted that the Commission rejected all of those very same arguments in Decision No. 73938.
Id. at 227:21-230:8, 231:13-19 (Mease).

³⁴ Ex. A-26 at 3, § I (definition of SIB Plant Table I); Ex. A-25 at 2, § I (definition of SIB Plant Table I);
Ex. A-19 at 4, § 2.4 (“A list of these projects and an estimation of the capital costs of each is set forth in

1 LPSCO proposes for SIB treatment in this proceeding are listed in SIB Plant Table I for
2 both the water and wastewater SIBs.³⁵ Just like with AWC, Staff has reviewed all of
3 those SIB-Eligible Projects listed on Plant Tables I for LPSCO's water and wastewater
4 divisions and approved the costs of those SIB-Eligible Projects.³⁶

5 All of the Commission-approved projects that are included in a SIB surcharge
6 filing for LPSCO must be completed and placed in service prior to the SIB surcharge
7 going into effect—just as required for the AWC SIB.³⁷ If circumstances require adding a
8 qualifying project to the list of SIB-Eligible Projects, the LPSCO SIBs and the AWC SIB
9 contain similar criteria for doing so.³⁸ Additionally, both the LPSCO SIBs and the AWC
10 Settlement Agreement require the utilities to file a report with the Commission every
11 six months summarizing the status of all SIB-Eligible Projects.³⁹

12 SIB Plant Table I, attached hereto as Exhibit A”).

13 ³⁵ Ex. A-20 at 13; Ex. A-21 at 18. Table 7 is equivalent to Table I. *See* Hains Dt., Engineering Report at
14 13-14.

15 ³⁶ Tr. at 199:25-200:14 (Hains)(“Q. All right. And in your review of those tables submitted by the
16 Company, did Staff find the plant cost to be reasonable and appropriate? A. Yes.”).

17 ³⁷ Ex. A-25 at 2, § I (“The SIB provides for recovery of the capital costs (return on investment, income
18 taxes and depreciation expense) associated with collection system improvement projects listed in SIB
19 Plant Table I that have been verified to be completed and placed in service per SIB Plant Table II and
20 where costs have not been included in rate base for recovery...”; Ex. A-26 at 2, § I (same). *See also*
21 Ex. A-25 at 4, § III(C)(1)(a-d); Ex. A-26 at 4, § III(C)(1)(a-d). *Compare* Ex. A-19 at 5, § 2.5 (“AWC may
22 seek a SIB surcharge for projects on SIB Plant Table I that have been completed and placed into service,
23 per SIB Plant Table II...”)).

24 ³⁸ Ex. A-25 at 8, § V(A-D); Ex. A-26 at 8, § V(A-D); Ex. A-19 at 6-7, §§ 6.1-6.4. As stated in the POAs,
25 “the Company can seek Commission approval to add projects in SIB Plant Table I only in the event of
26 emergency circumstances.” Ex. A-25 at 8, § V(A); Ex. A-26 at 8, § V(A). Further, under the POAs, SIB-
Eligible Plant must satisfy at least one of the following conditions: (1) water loss exceeding 10%
(for water) or replacement plant necessary to address excessive infiltration and inflow (for wastewater);
(2) assets have remained in service beyond their useful service lives; or (3) any other engineering,
operational or financial justification supporting replacement, including increased levels of repairs or
failures, meter replacements and assets required to be moved or replaced by a government agency.
Ex. A-25 at 8, § V(A-D); Ex. A-26 at 8, § V(A-D).

³⁹ Ex. A-19 at 6, § 4.8 (“Every six (6) months, AWC shall file a report with Docket Control delineating the
status of all SIB eligible projects listed per SIB Plant Table I above, and may include modifications to that
list for approval by the Commission using the process referenced in Section 6.0.”); Ex. A-25 at 3,
§ III(A)(“Once a SIB is approved in a decision, the Company must file with Docket Control semi-annual
status reports delineating the status of all SIB Eligible Plant, on a project by project basis as listed in SIB
Plant Table I, starting 6 months after the decision and every 6 months thereafter.”); Ex. A-26 at 3-4,

1 **3. SIB Project Eligibility Criteria.**

2 The LPSCO SIBs and the AWC SIB contain and apply the same fundamental
3 criteria for SIB-Eligible Projects. As stated in § I of the LPSCO POAs, SIB-Eligible
4 Projects are “necessary to provide and continue to provide proper, adequate and reliable
5 service to existing customers; are not designed to serve or promote customer growth; and
6 will not comprise an upgrade or expansion of existing plant unless justified for existing
7 customers...”⁴⁰ Those protections are identical to § 2.1 of the AWC Settlement
8 Agreement limiting the SIB to projects that are “necessary to provide proper, adequate
9 and reliable service to existing customers; are not designed to serve or promote customer
10 growth; and will not comprise an upgrade or expansion of existing plant...”⁴¹

11 **4. Surcharge Calculation, Efficiency Credit and Surcharge Cap.**

12 Just like the AWC Settlement Agreement, the SIB rate of return, depreciation rate,
13 and tax multiplier for LPSCO are equal to those to be approved by the Commission in this
14 general rate case.⁴² Likewise, for both LPSCO and AWC, the calculation of the SIB
15 surcharge will also take into account any related plant retirements.⁴³

16 Based on the AWC SIB template, the LPSCO SIBs also include an Efficiency
17 Credit equal to five percent of the SIB surcharge that will be deducted from the SIB
18 surcharges essentially giving revenue back to customers in the form of the efficiency
19 credit.⁴⁴ For both LPSCO and AWC, the amount to be collected from each SIB surcharge

20 § III(A)(same).

21 ⁴⁰ Ex. A-25 at 2, § I; Ex. A-26 at 2, § I.

22 ⁴¹ Ex. A-19 at 4, § 2.1.

23 ⁴² Ex. A-25 at 6, § IV(A)(1); Ex. A-26 at 6, § IV(A)(1); Ex. A-19, at 5, § 3.2 (applying the SIB rate of
return, tax multiplier and depreciation as approved by the Commission in Decision No. 73736 (Feb. 20,
2013)).

24 ⁴³ Ex. A-19, at 5, § 3.2; Ex. A-25 at 3, § I (definition of SIB Plant Table II); Ex. A-26 at 3, § I (definition
of SIB Plant Table II).

25 ⁴⁴ Ex. A-25 at 3 (definition of SIB Surcharge Efficiency Credit) and 6, § IV(A)(1)(“The amount to be
26 collected by the SIB Authorized Revenue shall be equal to the SIB Revenue Requirement minus the SIB
Revenue Requirements Efficiency Credit...”); Ex. A-26 at 3, (same) and 6, § IV(A)(1)(same).

1 is capped annually at five percent of the revenue requirement authorized in the
2 Company's most recent general rate case.⁴⁵ The LPSCO SIBs and the AWC SIB contain
3 identical true-up and reconciliation provisions requiring the utilities to file annual reports
4 to true up any over or under collections as established by the Commission.⁴⁶

5 **5. SIB Surcharge Rate Design and Commission Approval.**

6 The LPSCO SIBs and the AWC SIB involve the same SIB Surcharge rate design
7 with surcharges set as a fixed monthly surcharge and presented on customer bills.
8 The SIB fixed surcharge and SIB efficiency credit will appear as two separate line items.⁴⁷
9 The surcharges for both would increase with meter size based on the flow capacity of the
10 meter or lateral size.⁴⁸ Additionally, for both LPSCO and AWC, each SIB surcharge shall
11 not become effective until reviewed and approved by the Commission based on a fair
12 value analysis.⁴⁹

13 **6. SIB Surcharge Filings Allowed Between General Rate Cases.**

14 Just like AWC, LPSCO may file up to five SIB surcharges for each of its
15 ratemaking systems between general rate cases, with the initial filing being no sooner than
16 12 months after the date of the Commission's decision in this rate case.⁵⁰ LPSCO may
17 file no more than one SIB surcharge every 12 months for each ratemaking system.⁵¹
18 Again like AWC, LPSCO must file its next general rate case application no later five
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20

21 *Compare* Ex. A-19 at 5, §§ 3.1 ("The amount to be collected by the SIB Surcharge...shall be equal to the
22 SIB Revenue Requirement minus the SIB efficiency credit"), 3.3 ("The SIB Efficiency Credit shall be
equal to five percent of the SIB revenue requirement.").

23 ⁴⁵ Ex. A-19 at 5, § 3.4; Ex. A-25 at 6, § IV(A)(3); Ex. A-26 at 6, § IV(A)(3).

24 ⁴⁶ Ex. A-19 at 6, § 4.9; Ex. A-25 at 4, § III(B); Ex. A-26 at 4, § III(B).

25 ⁴⁷ Ex. A-19 at 9, § 8.1; Ex. A-25 at 9, § VI(A); Ex. A-26 at 9, § VI(A).

26 ⁴⁸ Ex. A-19 at 9-10, § 8.1.2; Ex. A-25 at 9, § VI(A)(2); Ex. A-26 at 9, § VI(A)(2).

⁴⁹ Ex. A-19 at 10, § 9.2; Ex. A-25 at 9, § VII(A); Ex. A-26 at 9, § VII(A).

⁵⁰ Ex. A-19 at 5, §§ 4.4-4.5; Ex. A-25 at 5, § III(F); Ex. A-26 at 5, § III(F).

⁵¹ *Id.*

1 years after a decision is rendered in this case, and any SIB surcharges then in effect will
2 be reset to zero.⁵²

3 **7. Public Notice to Customers.**

4 Finally, just like AWC, at least 30 days prior to a SIB surcharge becoming
5 effective, LPSCO shall provide public notice in the form of a billing insert or customer
6 letter that summarizes the amount of SIB surcharge and SIB efficiency credit, as well as
7 summarizing the projects included in the surcharge and their associated cost.⁵³

8 **8. Earnings Test.**

9 In the POAs, LPSCO goes one step further than the SIB originally proposed by
10 AWC by including provisions relating to a SIB earnings test—a requirement imposed by
11 the Commission for AWC in Decision No. 73938.⁵⁴ Specifically, LPSCO is required
12 “to perform an annual earnings test calculation for each SIB Surcharge Request to
13 determine whether the actual rate of return” exceeds the return authorized by the
14 Commission.⁵⁵

15 **B. Approval of LPSCO’s Proposed SIBs is within the Commission’s Legal**
16 **Authority and Complies With Arizona Law**

17 Based on fundamentally identical terms and conditions as LPSCO’s SIBs, the
18 Commission determined “that that the SIB mechanism embodied in the [AWC]
19 Settlement Agreement, together with the additional financial information and analysis
20 required herein, is compliant with the Commission’s constitutional requirements, as well
21 as the case law interpreting the Commission’s authority and discretion in setting rates.”⁵⁶
22 For our purposes here, the Commission found that “[w]ith these provisions and

23 ⁵² Ex. A-25 at 5, § III(G); Ex. A-26 at 5, § III(G). *Compare* Ex. A-19 at 6, §§ 4.6-4.7.

24 ⁵³ Ex. A-19 at 9, § 7.2; Ex. A-25 at 9-10, § VII(B); Ex. A-26 at 10, § VII(B).

25 ⁵⁴ Ex. A-25 at 7-8, § IV(C); Ex. A-26 at 7, § IV(C); Decision No. 73938 at 50-51.

26 ⁵⁵ Ex. A-25 at 7, § IV(C)(1); Ex. A-26 at 7, § IV(C)(1).

⁵⁶ Decision No. 73938 at 53.

1 protections” the AWC SIB “is in accord with Arizona law and, as a whole, is consistent
2 with the public interest.”⁵⁷ Those provisions and protections are the same SIB terms and
3 conditions set forth above and contained in the LPSCO POAs.

4 In Decision No. 73938, the Commission explained that “[a]fter reviewing the court
5 decisions interpreting the constitutional requirements imposed on the Commission’s
6 ratemaking authority, we believe that the [AWC] Settlement Agreement, and the SIB
7 mechanism incorporated therein, together with the financial information and analysis
8 required herein, satisfies the fair value concerns addressed by various court decisions.”⁵⁸
9 As a matter of law and fact, LPSCO’s SIBs for its water and wastewater divisions are
10 legal under Arizona law for the same reasons as stated in Decision No. 73938.

11 **1. The SIB complies with Arizona’s fair value requirement.**

12 On pages 41-54 of Decision No. 73938, the Commission provided an in-depth
13 analysis of the legality of AWC’s SIB under Arizona’s fair value standard and associated
14 case law. LPSCO incorporates those pages of Decision No. 73938 by reference.

15 To ensure fair treatment by utilities, Arizona’s constitutional framers established
16 the Commission in Article 15 of our Constitution. Article 15 both empowered and
17 restricted the entity it created. In Article 15, § 3, the framers instructed the Commission
18 to set rates. As a check on the Commission, the framers also established “fair value” in
19 Article 15, § 14 as the mandatory yardstick for measuring utility rates. Under that
20 framework, §§ 3 and 14 operate cohesively to mandate just and reasonable rates based on
21 the fair value of a utility’s property. Each section imposes separate obligations on the
22 Commission. Section 3 mandates that the Commission set and prescribe utility rates.
23 Section 14 requires that the Commission perform a fair value analysis in that rate
24 prescription process and set the utility’s rates accordingly.

25 ⁵⁷ *Id.* at 54.

26 ⁵⁸ *Id.* at 50.

1 As the Arizona Supreme Court explained in *Simms*, “[w]hile our constitution does
2 not establish a formula for arriving at fair value, it does require such value to be found and
3 used as the base in fixing rates. The reasonable and justness of the rates must be related to
4 this finding of fair value.”⁵⁹ “Fair value means the value of properties at the time of
5 inquiry.”⁶⁰ “Under the laws of fair value, a utility...is entitled to a fair return on the fair
6 value of its properties devoted to the public use, no more and no less.”⁶¹
7 “[The Commission] is required by our Constitution to ascertain the value of a utility’s
8 property within the state in setting just and reasonable rates.”⁶²

9 Here, the SIBs proposed by LPSCO require a determination of the fair value of the
10 Company’s rate base along with the SIB plant at the time that the surcharges are proposed.
11 As set forth in SIB Schedule D, and as testified by Mr. Krygier, the SIB mechanisms
12 require a finding of FVRB for LPSCO relating to the SIB filings.⁶³

13 On their plain terms, LPSCO’s SIB mechanisms clearly comply with Arizona’s fair
14 value standard and accompanying case law. Ultimately, all the Arizona Constitution
15 requires is that the Commission determine and consider fair value in setting rates or

16 ⁵⁹ *Simms v. Round Valley Light & Power Co.*, 80 Ariz. 145, 151, 294 P.2d 378, 384 (1956).

17 ⁶⁰ *Simms*, 80 Ariz. at 151, 294 P.2d at 382 (internal citation omitted). See also *Consolidated Water*
18 *Utilities, Ltd., v. Arizona Corp. Comm’n*, 178 Ariz. 478, 482 n. 6, 875 P.2d 137, 141 n. 6 (App. 1993)
19 (“The fair value rate base is the fair value of the company’s properties within the state at the time the rate
20 is fixed.”); *Los Angeles Gas & Electric*, 289 U.S. at 305 (a utility is entitled to “a fair return upon the
reasonable value of the property at the time it is being used for the public”); *Southwestern Bell*, 262 U.S. at
21 286 (“[T]he value of the property is to be determined as of the time when the inquiry is made regarding
the rates.”), quoting *Willcox v. Consol. Gas Co.*, 212 U.S. 19, 52 (1909).

22 ⁶¹ *Arizona Corporation Comm’n v. Arizona Water Co.*, 85 Ariz. 198, 201, 335 P.2d 412, 415 (1959).

23 ⁶² *Scates v. Arizona Corporation Comm’n*, 118 Ariz. 531, 534, 578 P.2d 612, 615 (App. 1978).

24 ⁶³ Ex. A-25 at 5, § III(C)(6) (“SIB Schedule D (sample attached as Exhibit 6) which shall include an
25 analysis of the impact of the SIB Eligible Plant on the fair value rate base, revenue, and the fair value rate
26 of return.”); Ex. A-26 at 5, § III(C)(6)(same). See also Tr. at 84:17-85:5 (Krygier) (“Q. All right. And
within, and I am going to just ask you for some lay understanding here. I am not asking your opinion as
an attorney, but within the plan of administration, is there a requirement that the Commission review the
[C]ompany’s fair value rate base in connection with its review of the SIB and the SIB filings? A. Yes. If
you look in the plan of administration, and I am looking particularly at the wastewater version, it starts on
the bottom of page 4, you see a number 6 there, SIB Schedule D...which shall include an analysis of the
impact of the SIB eligible plant on the fair value rate base.”).

1 approving a mechanism like the SIB. The Arizona Supreme Court's decision in *US West*
2 *Comm., Inc. v. Arizona Corp. Comm'n*, illustrates that point:

3 ...We hold that a determination of fair value is necessary with respect to a
4 public service corporation. But what is to be done with such a finding? In
5 the past, fair value has been the factor by which a reasonable rate of return
6 was multiplied to yield, with the addition of operating expenses, the total
7 revenue that the corporation could earn...That revenue figure was then used
8 to set rates...But while the Constitution clearly requires the Arizona
9 Corporation Commission to perform a fair value determination, only our
10 jurisprudence dictates that this finding be plugged into a rigid formula as
11 part of the rate-setting process. Neither section 3 nor section 14 of the
12 constitution requires the corporation commission to use fair value as the
13 *exclusive* rate basis...In this and any other fashion that the corporation
14 commission deems appropriate, the fair value determination should be
15 considered. The commission has broad discretion, however, to determine
16 the weight to be given this factor in any particular case.⁶⁴

11 The Court of Appeals' decision in *Phelps Dodge Corp. v. Arizona Corp. Comm'n* echoes
12 those sentiments: "...consistent with the pronouncement in *US West II*...the Commission
13 should consider fair value when setting rates within a competitive market, although the
14 Commission has broad discretion in determining the weight to be given that factor in any
15 particular case."⁶⁵ Here, the SIBs require consideration of FVRB in determining the
16 surcharge, thus complying with Arizona's fair value requirement.

17 2. **The proposed SIBs for LPSCO are lawful adjuster mechanisms**
18 **under Arizona law.**

19 The Commission has broad discretion in setting rates, including consideration and
20 use of various ratemaking mechanisms as long as the method complies with the fair value
21 mandate set forth in Article 15, § 14.⁶⁶ Put simply, the Commission has discretion to

22 ⁶⁴ 201 Ariz. 242, 244-245, 34 P.3d 351, 353-355 (2001).

23 ⁶⁵ 207 Ariz. 95, 107, 83 P.3d 573, 585 (Ct. App. 2004).

24 ⁶⁶ *Arizona Corp. Comm'n v. Arizona Pub. Serv. Co.*, 113 Ariz. 368, 555 P.2d 326 (1976) ("...the
25 Commission in its discretion can consider matters subsequent to the historic year" when establishing fair
26 value rate base in a rate case); *Arizona Cmty. Action Ass'n v. Arizona Corp. Comm'n*, 123 Ariz. 228, 599
P.2d 184 (1979)(upholding a Commission decision that allowed inclusion of CWIP for plant that was
under construction during the test year and would go into service within two years after the effective date
of a Step II rate increase when the step increase methodology had been created in full rate case, including a

1 adopt mechanisms necessary to address particular ratemaking issues, including matters
2 subsequent to an historic test year,⁶⁷ construction projects contracted and commenced
3 during the test year,⁶⁸ and construction work in progress but not yet in service.⁶⁹ Further,
4 the Commission may adopt interim rates or automatic adjustment mechanisms without
5 first determining FVRB.⁷⁰

6 With this broad discretion in hand, for example, the Commission has approved
7 ACRM to help utilities finance compliance with the federal arsenic drinking water
8 standards.⁷¹ In Decision No. 73938, the Commission specifically found that “the [AWC]
9 SIB would operate very similarly to the existing ACRM, with which the Commission now
10 has extensive experience, and which the Commission has determined to be lawful.”⁷²
11 The Commission lawfully approved all of these mechanisms and those decisions support,
12 if not mandate, approval of the SIBs here.

13 Fundamentally, SIBs are ratemaking adjuster mechanisms designed to provide for
14 the timely recovery of capital costs (depreciation expense and pre-tax return on
15 investment) invested by utilities in system improvement projects meeting specific criteria.
16 Boiled down, the SIB is an adjustor mechanism, as Mr. Olea testified in the AWC case.⁷³
17 Moreover, the SIB is a type of DSIC, and the courts in Pennsylvania have recognized that
18 DSICs are adjustor mechanisms.⁷⁴ The SIB also meets the definition of adjustors used in
19

20 determination of fair value).

21 ⁶⁷ *Arizona Pub. Serv.*, 113 Ariz. at 371.

22 ⁶⁸ *Id.*

23 ⁶⁹ *Arizona Cmty. Action*, 123 Ariz. at 230, 599 P.2d at 186.

24 ⁷⁰ *RUCO v. Arizona Corp. Comm’n*, 199 Ariz. 588, 20 P.2d 1169 (Ct. App. 2011).

25 ⁷¹ *See* Decision No. 73938 at 46; *AWC*, Decision No. 66400 (Oct. 14, 2003) at 17, 19-20, 22.

26 ⁷² Decision No. 73938 at 50.

⁷³ Transcript from April 11, 2013 hearing at 297:21 – 298:3, AWC Rate Case.

⁷⁴ *See Popowsky v. Pennsylvania Pub. Util. Comm’n*, 869 A.2d 1144, 1158 (Pa. Comm. Ct. 2005) (stating that “water utilities may recover certain capital costs through an automatic adjustment clause in its tariff” and treating a DSIC for water as an automatic adjustment clause).

1 many ratemaking authorities and treatises.⁷⁵ On that issue, the Commission determined in
2 Decision No. 73938 that the AWC SIB “is an adjustment mechanism established within a
3 rate case as part of a company’s rate structure...”⁷⁶ The same holds true for LPSCO’s
4 proposed SIBs here.

5 Arizona law does not prohibit such a ratemaking adjuster mechanism as long as the
6 mechanism is approved in a general rate case and comports with Arizona’s fair value
7 requirement in Article 15, § 14 of the Arizona Constitution.⁷⁷ On its terms, the SIB meets
8 the fundamental requirements of *Scates*—“when courts have upheld automatic adjustment
9 provisions, they have generally done so because the clauses are initially adopted as part of
10 the utility’s rate structure in accordance with all statutory and constitutional requirements
11 and, further, because they are designed to insure that, through the adoption of a set
12 formula geared to a specific readily identifiable cost, the utility’s profit or rate of return
13 does not change.”⁷⁸

14 LPSCO’s SIBs satisfy both elements of *Scates* because LPSCO seeks approval of
15 the SIBs in a general rate case, the Commission will make a fair value finding in setting
16 rates, the SIBs require an evaluation and finding of fair value as part of the required SIB
17 filings and the SIB rate of return is limited to that approved by the Commission in this

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19 ⁷⁵ See, e.g., Morin, *New Regulatory Finance* (2006) at 556 (defining adjusters relative to costs and noting
20 that “[u]nder this style of regulation, an automatic adjustment factor is applied to individual cost
21 components that are outside the control of management.”); 73B C.J.S. Public Utilities § 120 (“Approval by
22 a public utility regulatory commission of tariff provisions for automatic adjustments in rates according to a
23 predetermined formula, without the necessity for proceedings by the commission whenever specified costs
24 of the utility change by a certain amount, may be permissible.”); 16 U.S.C. § 824d(f)(4) (“As used in this
25 subsection, the term “automatic adjustment clause” means a provision of a rate schedule which provides
26 for increases or decreases (or both), without prior hearing, in rates reflecting increases or decreases (or
both) in costs incurred by an electric utility...”).

⁷⁶ Decision No. 73938 at 52. In that decision, the Commission further stated that “[t]he SIB is a different
type of adjuster mechanism than has been previously been reviewed by the courts because it allows
recovery of plant costs associated with AWC’s substantial distribution system improvement needs, rather
than fuel costs.” *Id.*, n. 39.

⁷⁷ *Scates*, 118 Ariz. at 535, 578 P.2d at 616.

⁷⁸ *Id.* (citations omitted).

1 case. Therefore, the LPSCO SIBs comply with Arizona law—as determined by the
2 Commission for the AWC SIB in Decision No. 73938.⁷⁹

3 **3. The SIBs comply with all requirements for an adjustment**
4 **mechanism under Arizona law.**

5 Aside from the fair value requirement, the LPSCO SIBs comply will all required
6 elements for a valid adjuster under Arizona law. To start, any decision by the
7 Commission approving the SIBs is part and parcel of LPSCO's general rate case.
8 Thus, the SIB is not extraordinary ratemaking conducted outside the norm.
9 The Commission has approved many types of adjusters and similar mechanisms in other
10 dockets. The fact that the SIB is part of the Company's rate case, including consideration
11 of all ratemaking elements and standards used in a general rate case, coupled with the
12 protections embedded in the SIBs, necessarily means that the LPSCO SIBs comply with
13 Arizona law.⁸⁰

14 As expressly stated by the Commission in Decision No. 73938, the SIB is a
15 different type of adjuster mechanism designed around recovery of the costs of plant
16 investment in system improvements.⁸¹ Unlike the circumstances at issue in *Scates*,
17 approval of the SIB in this general rate case would be done as part of LPSCO's rate
18 structure in accordance with statutory and constitutional ratemaking requirements.
19 Further, the SIB only applies to projects meeting specific criteria, and the SIB applies a
20 set formula to readily identifiable and defined plant for calculation of the SIB surcharge.⁸²
21 On top of those requirements, the SIBs only use the rates of return set by the Commission
22 in this rate case docket, thereby ensuring that the utility's authorized rate of return does
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24 ⁷⁹ Decision No. 73938 at 50.

25 ⁸⁰ *Scates*, 118 Ariz. at 535, 578 P.2d at 616.

26 ⁸¹ Decision No. 73938 at 52.

⁸² Ex. A-25 at 2-3, § II and 6, § IV(A); Ex. A-26 at 2-3, § II and 6, § IV(A).

1 not change from any SIB filings.⁸³ Under these circumstances, the SIB is a lawful
2 adjuster mechanism under *Scates* and other Arizona case law.

3 Further, even if the Commission were to reverse course and determine that the SIB
4 is not a ratemaking adjuster mechanism, it is still a lawful ratemaking surcharge
5 authorizing rate increases based on a determination and evaluation of the Company's
6 FVRB.⁸⁴ Under *RUCO v. Arizona Corp. Comm'n*, the Commission is authorized to
7 impose rate surcharges for specific costs or issues if the Commission first determines and
8 considers the utility's FVRB.⁸⁵

9 As requested, LPSCO's SIB mechanisms are tailored to meet and exceed all
10 Arizona ratemaking legal requirements. The ratemaking terms, conditions and protections
11 set forth in LPSCO's POAs can't be understated. For starters, the SIBs would be
12 approved in the Company's general rate case, authorizing the Company to implement the
13 surcharge in the years before the Company's next general rate case. On its own terms,
14 the SIB mechanism is linked to the Company's general rate case by requiring that the rate
15 of return, depreciation rates and gross revenue conversion factor approved by the
16 Commission here be applied to any SIB filings. Further, SIB plant is subject to a detailed
17 review as part of this rate case before a project is included on the list of SIB-Eligible
18 Plant, and then a subsequent review after the project is completed and prior to any
19 surcharges.

20 The extensive protections contained in the POAs don't stop there. Not only is the
21 rate of return from the Company's general rate case used in calculating the SIB, but the
22 SIB mandates application of a "SIB Revenue Requirement Efficiency Credit" equal to

23 ⁸³ Ex. A-25 at 6, § IV(A)(1); Ex. A-26 at 6, § IV(A)(1).

24 ⁸⁴ *RUCO v. Ariz. Corp. Comm'n*, 199 Ariz. at 589, 20 P.3d at 1170 ("We hold that in the absence of an
25 emergency or automatic adjustment clause, the Arizona Corporation Commission cannot impose a rate
26 surcharge based on a specific cost increase without first determining a utility's fair value rate
base.") (emphasis added).

⁸⁵ *Id.*

1 five percent of the SIB Revenue Requirement.”⁸⁶ That five percent efficiency credit is
2 then deducted from the SIB revenue requirement, directly reducing the SIB revenue
3 requirement and effectively reducing the return on equity for plant investments under the
4 SIB, in turn further assuring that LPSCO’s rate of return does not increase.

5 Under the proposed SIB, the Company is limited to one SIB filing every twelve
6 months and no more than five SIB filings between rate case decisions.⁸⁷ Further, the SIB
7 also requires reconciliation and true-up of any and all amounts collected. Specifically,
8 “[t]he revenue collected by the SIB Surcharges over the preceding twelve months shall be
9 trued-up and reconciled with the SIB Authorized Revenue for that period,” including the
10 recovery or refund of any over/under collected balances, again ensuring that Liberty’s rate
11 of return does not increase.⁸⁸ On its terms, the various provisions and protections under
12 the SIBs require evaluation and consideration of FVRB relating to any SIB filings and
13 approved surcharges, and guarantee compliance with Arizona law.

14 **4. If the APS EIS is legal, then so are the LPSCO SIBs.**

15 Not only does the SIB comply with Arizona law, as noted above, it is virtually the
16 same as other ratemaking adjuster mechanisms approved by the Commission and accepted
17 without any legal challenges. Perhaps the best illustration is the Commission’s approval
18 of APS’s EIS in Decision No. 73183 (May 24, 2012) discussed in detail below. That EIS
19 mechanism was approved in accordance with a settlement agreement signed by APS,
20 Staff, RUCO and various other parties on or about January 6, 2012 without any challenge
21 to that surcharge’s legality.⁸⁹

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24 ⁸⁶ Ex. A-25 at 3, § II; Ex. A-26 at 3, § II.

25 ⁸⁷ Ex. A-25 at 5, § III(F); Ex. A-26 at 5, § III(F).

26 ⁸⁸ Ex. A-25 at 7, § IV(B)(1); Ex. A-26 at 7, § IV(B)(1).

⁸⁹ Decision No. 73183, Exhibit A.

1 The EIS and SIBs are materially identical adjuster mechanisms. In approving the
2 EIS for APS, the Commission affirmed the legality of the EIS, indirectly affirming the
3 legality of the SIB mechanism because of the close similarities between the SIBs and the
4 EIS. Put simply, if the EIS is valid and legal, then so are the SIBs. Or, put another way,
5 if the Commission determines that the SIBs are illegal in this case, the Commission
6 likewise would have to nullify the EIS as illegal, in turn unraveling the APS rate case
7 settlement.⁹⁰ In that event, the Commission also would have to unravel the AWC SIB.

8 Without a doubt, LPSCO's SIBs (and AWC's) are a virtual mirror image of the
9 EIS for APS. The similarities are striking and demonstrative. Prior to its rate case in
10 2011, APS had an approved EIS for compliance costs associated with environmental
11 regulations. That EIS treated the customer surcharges as contributions in aid of
12 construction. In its 2011 rate filing, APS requested modifications to its EIS to provide
13 APS with a return on capital it invested in environmental compliance. Subsequently,
14 APS, Staff, RUCO and various other parties reached a settlement of the 2011 rate case.
15 RUCO signed and supported that settlement agreement including an agreement relating to
16 amendments to the EIS for APS: "As amended, APS shall no longer receive customer
17 dollars through the EIS to pay for government-mandated environmental controls.
18 However, when APS invests capital to fund any government-mandated environmental
19 controls, the EIS will recover the associated capital carrying costs, subject to a cap equal
20 to the charge currently in place for the EIS."⁹¹ The SIB here is subject to the same type of
21 cap.

22
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24 ⁹⁰ Interestingly, by challenging the SIB mechanism as illegal in this docket, RUCO has indirectly
25 challenged the EIS as illegal. That is a violation of the APS Settlement Agreement approved by the
26 Commission and signed by RUCO, which requires that "the Signatories [including RUCO] will support
and defend the Commission's order before any court or regulatory agency in which it may be at issue."
APS Settlement Agreement at 22, ¶ 21.6.

⁹¹ *Id.* at 16, ¶ 11.2.

1 To qualify as an EIS eligible project, APS investments must be classified in one or
2 more of 20 FERC accounts listed in APS's EIS Plan of Administration.⁹² To qualify as a
3 SIB-Eligible Project here, the Company's plant investments must be classified in one or
4 more of various NARUC accounts listed in the POAs.⁹³

5 The EIS is calculated based on capital carrying costs, including "(1) Return on EIS
6 Qualified Investments based on the Company's WACC approved by the Commission in
7 Decision No. 73183; (2) depreciation expense; (3) income taxes; (4) property taxes; (5)
8 deferred income taxes and tax credits where appropriate; and (6) associated O&M."⁹⁴
9 The SIBs here are likewise based on the first three of the items used to calculate APS's
10 EIS. In this way, both the SIB and EIS provide a return on utility investment in plant
11 based on each company's WACC as approved by the Commission in each company's
12 recent general rate case.

13 Ultimately, the SIB and EIS involve similar plant investments that are necessary to
14 ensure safe and reliable utility service. Not only are the SIB and EIS virtually identical
15 rate adjustment mechanisms, but the SIB contains additional protections over and above
16 the approved EIS. For example, the EIS doesn't require any quarterly or semi-annual
17 filings regarding actual investment in plant. The SIB, on the other hand, requires that
18 "Once a SIB is approved in a decision, the Company must file with Docket Control semi-
19 annual report delineating the status of all SIB-Eligible Plant, on a project by project basis
20 as listed in SIB Plant Table I, starting 6 months after the decision and every 6 months
21 thereafter."⁹⁵ Further, the EIS only requires APS to file required information listed on two
22 one-page schedules, (though admittedly the data APS provides is much more voluminous
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24 ⁹² *Id.* at Attachment H, § 3 (listing of qualified FERC accounts).

25 ⁹³ Ex. A-25 at 2, § II (listing SIB Eligible NARUC accounts for wastewater); Ex. A-26 at 2, § II (listing
SIB Eligible NARUC accounts for water).

26 ⁹⁴ APS Settlement Agreement, Attachment H, § 4 (calculation of EIS capital carrying costs).

⁹⁵ Ex. A-25 at 3, § III(A); Ex. A-26 at 3-4, § III(A).

1 than two pages.).⁹⁶ The SIBs require LPSCO to file required information listed on four
2 schedules, and two additional tables listing detailed plant information.⁹⁷

3 Perhaps most importantly here, RUCO did not challenge the EIS as illegal or in
4 violation of Arizona ratemaking standards. To the contrary, RUCO signed the
5 APS Settlement Agreement and provided testimony supporting the EIS. In direct
6 testimony provided by its former director, RUCO stated “[t]he new EIS reimburses APS
7 for shareholder funds used for environmental improvements and is treated as revenues.”⁹⁸
8 Ms. Jerich also listed “[t]he establishment of the Environmental Improvement Surcharge
9 adjuster” as one of the “benefits to the Company.”⁹⁹ On that issue, if the EIS qualifies as
10 an adjuster for APS, then so do the SIBs for LPSCO. RUCO’s various arguments in
11 support of the EIS likewise support and apply to the SIBs for LPSCO.

12 C. The Commission Should Approve the Proposed SIBs for LPSCO’s
13 Water and Wastewater Divisions As in the Public Interest

14 For the reasons set forth above and based on the underlying factual record,
15 the proposed SIB surcharges for LPSCO’s water and wastewater divisions are in the
16 public interest and should be approved by the Commission as recommended by Staff and
17 the Company. The SIB mechanisms set forth in the SIB POAs are compliant with the
18 Commission’s constitutional requirements and the case law interpreting the Commission’s
19 authority and discretion in setting rates. As set forth in the POAs, the SIB surcharges will
20 be based on specific, verified, and in-service plant additions that are reviewed by Staff and
21 approved by the Commission prior to being implemented.¹⁰⁰ Under the POAs, LPSCO is
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23 ⁹⁶ APS Settlement Agreement, Attachment H at 4, Schedule 1: Qualified Investments for EIS and
24 Attachment H at 5, “Schedule 2: Capital Carrying Costs and Adjustor Calculation.

25 ⁹⁷ Exs. A-25 and A-26 at Schedules A-D.

26 ⁹⁸ Direct Testimony of Jodi A. Jerich (filed Jan. 18, 2012 in Docket No. E-01345A-11-0224) at 8.

⁹⁹ *Id.* at 10.

¹⁰⁰ *See* Decision No. 73938 at 53.

1 required to submit annual survey summary schedules showing the actual cost of the
2 infrastructure and supporting documentation that will enable the Commission to determine
3 how the proposed surcharge adjustments may impact the fair value rate of return for
4 LPSCO's water and wastewater divisions.¹⁰¹

5 On this record, the evidence clearly shows that the SIBs will enable LPSCO to
6 meet the challenge of replacing aging infrastructure; result in more gradual rate increases,
7 as strongly preferred by ratepayers; increase the time between and reduce the complexity
8 of rate cases; provide a direct monetary benefit to ratepayers through the 5 percent
9 efficiency credit, and keep LPSCO financially healthy so it can continue to provide safe
10 and reliable water service.¹⁰² As such, the Commission should approve the proposed SIBs
11 as in accordance with Arizona law and consistent with the public interest.¹⁰³

12 **IV. CONCLUSION**

13 Based on the foregoing, LPSCO respectfully requests the following relief:

- 14 a. A finding that the fair value of LPSCO's property devoted to water and
15 wastewater service is \$33,103,506 and \$24,190,673, respectively;
- 16 b. Approval of an overall rate of return on such rate base equal to 8.76 percent;
17 and
- 18 c. A determination of a revenue requirement for LPSCO's water division of
19 \$12,622,779, which constitute increases over adjusted test year water
20 revenues of \$1,421,511, or 12.69 percent over the test year.
- 21 d. A determination of a revenue requirement for LPSCO's wastewater division
22 of \$10,704,021, which constitute increases over adjusted test year
23 wastewater revenues of \$341,225, or 3.29 percent, over the test year.

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25 ¹⁰¹ *Id.*

26 ¹⁰² Krygier Dt. at 9-15; Krygier Rb. at 24; Tr. at 81:1 – 82:21 (Krygier).

¹⁰³ Decision No. 73938 at 54.

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By: Yela Robert